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THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 23.1.2007

CORAM

THE HON'BLE MR.JUSTICE P.D.DINAKARAN
AND
THE HON'BLE MRS.JUSTICE CHITRA VENKATARAMAN

T.C.(A).Nos.15 and 24 of 2003

Commissioner of Income Tax
Madurai . .. Appellant in both cases

Vs.

Tamilnadu Mercantile Bank Ltd.,
Tuticorin. .. Respondent in both cases

Appeals under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Madras, 'B' Bench dated 26.9.2002 made in ITA No.2776/Mds/1992 for the assessment year 1989-90 and order of the Income Tax Appellate Tribunal, Madras, 'C' Bench dated 30.9.2002 made in ITA No.2444/Mds/1993 for the assessment year 1990-91 (1) [ITA NO 32/92-93 dt.28.8.92 on the file of the Commissioner of Income Tax, (Appeal), Madurai (TC (A) No. 15/2003)] (2) ITA NO. 304/93-94 (AY 90-91)dated 14.7.93 on the file of the Commissioner of Income TAx, (Appeals-I), Madrai [TC(A) No. 24/03].

[PAN 47-016-CV-9750 dt. 10.3.92 and dated 29.3.93 on the file of the Deputy Commissioner (Special Range II), Madurai - 625 001]

For Appellant : Mrs.Pushya Sitaraman
Senior Standing Counsel (IT)
For Respondent : Mr.R.Vijayaraghavan

J U D G M E N T

(Delivered by P.D. DINAKARAN, J.)

These tax case appeals are directed against the orders of the Income-tax Appellate Tribunal dated 26.9.2002 made in ITA No.2776/Mds/1992 for the assessment year 1989-90 and order dated 30.9.2002 made in ITA No.2444/Mds/1993 for the assessment year 1990-91 raising the following common

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substantial question of law:

"Whether on the facts and circumstances of the case, the Tribunal was right in law in holding that interest on securities is taxable only on specified dates when it became due for payment and not on accrued basis?"

2.1. The brief facts of the case are that the assessee, while filing return of income for the assessment years 1989-90 and 1990-91, claimed exclusion of the sums representing the accrued interest for the period till 31.3.1989 and till 31.3.1990 for the respective assessment years, in respect of the securities held by them on the ground that it did not become due in the respective previous years and that even after the omission of Section 18 of the Income Tax Act, the interest on securities should be charged only when it becomes due for payment as it does not accrue on day to day basis.

2.2. The Assessing Officer, however, disallowed the claims of the assessee, holding that after the omission of Section 18 of the Act, i.e., after 8.7.1988, interest is to be assessed under the head "business" or "other sources" as the case may be, and therefore, the interest which accrues up to the end of the accounting year becomes taxable as the income of the previous year.

2.3. On appeals, at the instance of the assessee, the Commissioner of Income Tax (Appeals), held that the omission of Section 18 did not make any difference, and since the interest on securities falls due only on certain specified dates, the assessing officer was not justified in holding that the interest accrued up to the last day of the accounting year should be subjected to tax.

2.4. On appeals by the Revenue, the Tribunal following its earlier order in the assessee's own case dated 12.12.1994 made in I.T.A.Nos.1459 to 1461 of 1989, held that the assessing officer for earlier assessment years accepted the method of assessment of the assessee, viz., offering the interest for taxation on receipt of the same, but, without any change in circumstance, changed the method of assessment during the financial years in question, which is unsustainable and accordingly dismissed the appeals. Hence, the present appeals raising the common substantial question of law referred to above.

3. According to the learned Senior Standing Counsel for the Revenue, as Section 18 of the Income Tax Act has been removed from the statute from the assessment year 1989-90 onwards, the interest on securities has to be assessed under the head "Business" and

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since the assessee was maintaining its accounts on mercantile basis, the entire interest accrued has to be included in the total income.

4. Per contra, Mr.Vijayaraghavan, learned counsel for the assessee submits that the third proviso to Section 145(1) of the Income Tax Act was introduced to get over the removal of Section 18 of the Income Tax Act, and that even under Section 145 of the Act, method of accounting on due basis is recognised. The assessee is following mercantile system and so he is entitled to the benefit of Section 145 of the Act. In support of his contention, the learned counsel for the assessee relied on the decision in Commissioner of Income-tax v. Canara Bank [1992] 195 ITR 66 and Godhra Electricity Co. Ltd. v. Commissioner of Income-tax [1997] 225 ITR 746.

5. We have given careful consideration to the submissions of both sides.

6. Before going into the merits of the case, it is apt to refer the relevant statutory provisions, viz., Section 18 and 145 of the Income Tax Act:

"Section:18. Interest on securities.--

(1) The following amounts due to an assessee in the previous year shall be chargeable to income-tax under the head " Interest on securities ",--

(i) interest on any security of the Central or State Government not being interest payable under section 280D in respect of any annuity deposit made under Chapter XXIIA ;

(ii) interest on debentures or other securities for money issued by or on behalf of a local authority or a company or a corporation established by a Central, State or Provincial Act.

(2) Nothing contained in sub-section (1) shall be construed as precluding an assessee from being charged to income-tax in respect of any interest on securities received by him in a previous year if such interest had not been charged to income-tax for any earlier previous year.

145. Method of accounting.--

(1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with the method of

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accounting regularly employed by the assessee:

Provided that in any case where the accounts are correct and complete to the satisfaction of the Assessing Officer but the method employed is such that, in the opinion of the Assessing Officer, the income cannot properly be deduced therefrom, then the computation shall be made upon such basis and in such manner as the Assessing Officer may determine.

Provided further that where no method of accounting is regularaly employed by the assessee, any income by way of interest on securities shall be chargeable to tax as the income of the previous year in which such interest is due to the assessee.

Provided also that nothing contained in this sub-section shall preclude an assessee from being charged to income-tax in respect of any interest on securities received by him in a previous year if such interest had not been charged to income-tax for any earlier previous year.

(2) Where the Assessing Officer is not satisfied about the correctness or the completeness of the accounts of the assessee, or where no method of accounting has been regularly employed by the assessee, the Assessing Officer may make an assessment in the manner provided in section 144.

(emphasis supplied)

7. In view of the deletion of the Section 18 of the Act with effect from April 1, 1989, the third proviso to section 145(1) was inserted with effect from April 1, 1989, which is a saving clause. Although the amendment was with effect from April 1, 1989, it clearly provides that any income by way of interest on securities shall be chargeable to tax as the income of the previous year in which such interest is due to the assessee only where no method of accounting is regularly employed by the assessee. In other words, if the assessee is maintaining cash system of accounting, the aforesaid proviso would not apply. The legislative intent is that when the assessee is maintaining the cash system of accounting, income by way of interest on securities will have to be charged to tax only when the assessee actually receives the interest and not on the date on which interest on such securities might become due.

8. In Commissioner of Income-tax v. Canara Bank [1992] 195 ITR 66, the Division Bench of the Karnataka High Court held that in the case of interest on securities, the income fructifies to

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the assessee only when the securities yield interest and, only in such a situation is section 18 attracted.

9.1. In CIT v. Shoorji Vallabhdas and Co. [1962] 46 ITR 144, the Apex Court held as under:

> "Income-tax is a levy on income. No doubt, the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt ; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a hypothetical income, which does not materialise."
>
> (emphasis supplied)

9.2. In H.M.Kashiparekh and Co. Ltd. v. CIT [1960] 39 ITR 706, the Bombay High Court held as under:

> "Even so, (the failure to produce account books), we shall proceed on the footing that the assessee-company having followed the mercantile system of accounting, there must have been entries made in its books in the accounting year in respect of the amount of the commission. In our judgment, we would not be justified in attaching any particular importance in this case to the fact that the company followed the mercantile system of accounting. That would not have any particular bearing in applying the principle of real income to the facts of this case."
> ...
> "The principle of real income is not to be so subordinated as to amount virtually to a negation of it when a surrender or concession or rebate in respect of managing agency commission is made, agreed to or given on grounds of commercial expediency, simply because it takes place some time after the close of an accounting year. In examining any transaction and situation of this nature the court would have more regard to the reality and speciality of the situation rather than the purely theoretical or doctrinaire aspect of it. It will lay greater emphasis on the business aspect of the matter viewed as a whole when that can be done without disregarding statutory language."
>
> (emphasis supplied)

9.3. In Poona Electric Supply Co. Ltd. v. CIT [1965] 57 ITR 521, the Apex Court held as under:

> "Income-tax is a tax on the real income, i.e., the profits arrived at on commercial principles subject to the

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provisions of the Income-tax Act."

(emphasis supplied)

9.4. In Morvi Industries Ltd. v. CIT, [1971] 82 ITR 835, the Apex court emphasised the fact that the real question for decision was whether the income had really accrued or not. It is not a hypothetical accrual of income that has got to be taken into consideration but the real accrual of the income.

9.5. In State Bank of Travancore v. CIT [1986] 158 ITR 102 (SC), the Apex Court held as under:

> "An acceptable formula of co-relating the notion of real income in conjunction with the method of accounting for the purpose of the computation of income for the purpose of taxation is difficult to evolve. Besides, any strait-jacket formula is bound to create problems in its application to every situation, it must depend upon the facts and circumstances of each case. When and how does an income accrue and what are the consequences that follow from accrual of income are well-settled. The accrual must be real taking into account the actuality of the situation. Whether an accrual has taken place or not must, in appropriate cases, be judged on the principles of the real income theory. After accrual, non-charging of tax on the same because of certain conduct based on the ipse dixit of a particular assessee cannot be accepted. In determining the question whether it is hypothetical income or whether real income has materialised or not, various factors will have to be taken into account. It would be difficult and improper to extend the concept of real income to all cases depending upon the ipse dixit of the assessee which would then become a value judgment only. What has really accrued to the assessee has to be found out and what has accrued must be considered from the point of view of real income taking the probability or improbability of realisation in a realistic manner and dovetailing of these factors together but once the accrual takes place, on the conduct of the parties subsequent to the year of closing, an income which has accrued cannot be made 'no income'."
>
> (emphasis supplied)

9.6. Applying the above principles, the Apex Court in Godhra Electricity Co. Ltd., v. Commissioner of Income-tax, [1997] 225 ITR 746 held that:

> "The question whether there was real accrual of income to the assessee-company in respect of the enhanced charges for supply of electricity has to be considered by taking the probability or improbability of realisation in a realistic

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manner. If the matter is considered in this light, it is not possible to hold that there was real accrual of income to the assessee-company in respect of the enhanced charges for supply of electricity which were added by the Income-tax Officer while passing the assessment orders in respect of the assessment years under consideration. The Appellate Assistant Commissioner was right in deleting the said addition made by the Income-tax Officer and the Tribunal had rightly held that the claim at the increased rates as made by the assessee-company on the basis of which necessary entries were made represented only hypothetical income and the impugned amounts as brought to tax by the Income-tax Officer did not represent the income which had really accrued to the assessee-company during the relevant previous years. The High Court, in our opinion, was in error in upsetting the said view of the Tribunal."

(emphasis supplied)

10. In the instant case, there is no change in the method of accounting by the assessee. The assessing Officer accepted the method of accounting followed by the assessee during the earlier assessment years, but, without any change in circumstance, changed the method of assessment during the financial years in question, which in our considered opinion, is unsustainable. As already observed, even though Section 18 of the Act was deleted, the assessee is taxable for interest on securities only on specified dates when it becomes due for payment, in view of third proviso to Section 145(1) of the Act, which was in force during the relevant assessment years, as well as in the light of the well settled principles laid down in the catena of decisions referred to above.

In the result, these appeals are dismissed answering the substantial question of law raised against the Revenue and in favour of the assessee. No costs.

Sd/
Asst. Registrar

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Sub Asst.Registrar

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To:

1.The Assistant Registrar,
Income Tax Appellate Tribunal
Madras Bench "B", Chennai.

2.The Assistant Registrar,
Income Tax Appellate Tribunal
Madras Bench "C", Chennai.

3.The Asst. Registrar,
ITAT, Rajaji Bhavan,
Besant Nagar, III Floor,
Chennai-90.

4.The Commissioner of Income
Tax (Appeals) I, Madurai.

5.The Commissioner of
Income Tax, Madurai.

6.The Deputy Commissioner
Special Range II, Madurai.

2 CC TO M/S PUSHYA SITARAMAN (SR 4570, 4571) SSC IT

1 CC TO MR.R. VIJAYARAGHAVAN, ADVOCATE SR NO 4589

1 CC TO MR.J. BALACHANDAR, ADVOCATE SR 4587

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